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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
ENERGY DIVISION
Item # 63 I. D. #5403
RESOLUTION G-3385
DATE: April 13, 2006

R E S O L U T I O N

Resolution G-3385. Southwest Gas Corporation (SWG) requests approval of 2006 attrition year rate relief and other adjustments applicable to its Northern and Southern California Divisions and its South Lake Tahoe District. SWG's attrition adjustment methodology is denied. Other aspects of SWG's request are approved.

By Advice Letter 747 filed October 31, 2005.
By Advice Letter 747-A filed November 23, 2005.

SUMMARY

This Resolution denies SWG's 2006 attrition adjustment methodology that it filed with Advice Letter (AL) 747-A in so far as SWG included an allowance for customer growth. Decision 04-03-034, which approved the attrition methodology for SWG, did not include an allowance for customer growth. Other aspects of AL 747-A are approved.

The protest of the Office of Ratepayer Advocates against the inclusion of a customer growth allowance is granted.

SWG shall file a supplemental advice letter excluding an allowance for customer growth.

BACKGROUND

SWG filed AL 747 for 2006 attrition year rate relief and to make other rate adjustments for its Southern and Northern California divisions and for its South Lake Tahoe District.

Southern and Northern California Divisions - The combined impact of all attrition rate increases requested by SWG is \$3.4 million or a 2.9% increase in Southern California and \$1.1 million or a 2.8% increase in Northern California.

With regard to SWG's Northern and Southern California Divisions, SWG seeks authorization to:

1. Recover SWG's 2006 Attrition Year margin revenue pursuant to Decision (D.) 04-03-034, in SWG's 2003 General Rate Case, Application (A.) 02-02-012;
2. Update Balancing Account Surcharges applicable to the Core Fixed Cost Adjustment Mechanism;
3. Adjust transportation and storage rates to reflect currently effective upstream pipeline charges;
4. Eliminate the Baseline Balancing Account Adjustment Mechanism (BBAM); and
5. Update Balancing Account Surcharges applicable to the Noncore Fixed Cost Adjustment Mechanism and the Interstate Transportation Cost Adjustment in SWG's Southern California Division only.

Ordering Paragraph 11 of D.04-03-034 authorized SWG to file attrition adjustments consistent with a modification of ORA's attrition year methodology proposed in that proceeding. SWG submitted work papers detailing its attrition adjustment methodology with AL 747.

SWG requests that its proposed rates become effective January 1, 2006.

South Lake Tahoe District - Margin rates for SWG's South Lake Tahoe service territory are held at levels of March 17, 2004.

For the South Lake Tahoe District, SWG seeks authorization for:

1. Updated Balancing Account Surcharges applicable to the Core Fixed Cost Adjustment Mechanism (CFCAM) in its South Lake Tahoe District;

2. Adjusted transportation and storage rates to reflect currently effective upstream pipeline charges in South Lake Tahoe.

As required by the settlement agreement approved in D.05-03-010, the decision that authorized SWG to purchase and take over Avista's gas operations in the South Lake Tahoe area, margin rates for the South Lake Tahoe area will remain at the March 17, 2004 level through 2008.

Advice Letter 747-A includes a customer growth adjustment.

On November 21, 2005, ORA protested the inclusion of customer growth in SWG's attrition adjustment methodology in AL 747. SWG filed AL 747-A to replace in its entirety SWG AL 747 and to exclude the customer growth adjustment from the calculation of SWG's "net operational attrition adjustment" to margin in response to ORA's protest. However, review of SWG's workpapers reveals that SWG continues to include a customer growth adjustment to base margin.

NOTICE

Notices of ALs 747 and 747-A were made by publication in the Commission's Daily Calendar. SWG states that a copy of each of these Advice Letters was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

ORA argues that D.04-03-034 did not allow customer growth to be included in the attrition adjustment calculation.

On November 21, 2005, the Office of Ratepayer Advocates (ORA) protested AL 747 on the basis that SWG included an allowance for customer growth in the calculation of the 2006 attrition year adjustment to the authorized base margin for the Northern and Southern California Divisions. The effect of including customer growth increased base margin by \$1,170,544 for its Southern Division and \$301,628 for its Northern Division. ORA said that D.04-03-034 did not grant an allowance for customer growth, and that consequently SWG is not in compliance with D.04-03-034. ORA recommends that we deny AL 747 and direct SWG to submit an advice letter that complies with D.04-03-034, by eliminating customer growth from its estimates of attrition year adjustments.

ORA protested AL 747-A on December 12, 2005, saying that AL 747-A also includes the same allowances for customer growth.

SWG believes that D.04-03-034 and underlying evidence in A.02-02-012 support the use of customer growth in the attrition adjustment methodology.

SWG responded to ORA's second protest on December 19, 2005. (SWG did not respond to ORA's first protest since it apparently believed its supplemental AL 747-A would resolve ORA's concerns.)

SWG said that the record in A.02-02-012 is clear that additional margin related to forecasted attrition year customer bills and volumes should be included in SWG's base margin for balancing account treatment.

In its response to ORA's protest SWG pointed to its testimony in A.02-02-012 as reflecting its adjustment to base margin related to forecast attrition year customer bills and volumes. SWG quotes from its exhibits:

"Attrition year revenues and gas costs are calculated by applying present rates incorporated in Chapter 10 (without any surcharges) to the forecast attrition year billing determinants."

SWG also referred to testimony it provided in A.02-02-012 setting forth a four step process to develop attrition year base margin for balancing account treatment and the calculation of attrition margin rates, including applying present margin rates to forecast attrition year billing determinants as follows:

- Step 1 explains that SWG will adjust base margin by multiplying its currently effective margin rates by the ensuing attrition year's forecast bills and volumes. SWG said that this adjustment should not be construed as being, or equated with, an attrition year rate increase, but a restatement of revenue at SWG's currently effective margin rates.
- Step 2 explains that SWG's attrition year base margin for balancing account treatment and rate design is equal to the sum of the adjusted margin calculated in Step 1 plus the attrition year adjustment to margin as approved by the Commission. As discussed above, it is the calculation of the attrition year adjustment to margin that should be exclusive of margin

related to forecast attrition year bills and volumes. Such margin, however, should be included in attrition year base margin for balancing account treatment.

- Steps 3 and 4 describe the allocation of attrition year base margin to customer classes and the calculation of attrition year base margin rates. The restatement of revenue at present rates discussed in Step 1 does not result in an increase to margin rates because the attrition year bills and volumes used in that calculation are also used in the calculation of attrition year margin rates discussed in Step 4.

SWG then points to ORA's opening brief, page 30, asserting that the language reflected there clearly sets forth ORA's agreement in principle with the four step process described above:

"Second, the authorized base margin needs to be adjusted each year to account for attrition increases to the revenue requirement. (ORA/Enderby Id., p.30-9.) In its rebuttal testimony, SWG set out a four step process for accomplishing this (SWG/Congdon Id., p.3.). ORA generally agrees with this process except that it should be based upon whatever attrition mechanism and forecast the commission adopts rather than just SWG's proposal." [underscore added by SWG]

Finally, SWG asserts that the Commission adopted a customer growth allowance in D.04-03-034, and that the Commission also noted ORA's agreement with SWG:

"ORA agrees with annual adjustments to the balancing account, however, such adjustments depend on the attrition mechanism discussed elsewhere in this decision." (D.04-03-034 slip opinion p. 9)

"We will adopt ORA's proposed attrition year methodology, modified by Southwest's changes except for the kicker¹." [underscore added] (D.04-03-034 slip opinion p. 62)

¹ The "kicker" refers to ORA's proposed 1 percent increase added to a 1.6 percent inflation factor to compensate for SWG's increase in pipeline replacement expenditure.

“The revenue balancing account treatment recommended by Southwest and ORA protects Southwest against risk due to a loss of revenues, and thus removes a risk affecting the adopted ROE.” [underscore added]
(D.04-03-034, Finding of Fact No. 80)

SWG said it must invest in facilities necessary to provide service to new customers and asserted that ORA’s protest of Advice Letter 747-A effectively imposes a growth penalty by denying SWG recovery of margin it would otherwise earn from forecasted customer growth. If adopted by the Commission, according to SWG, ORA’s recommendation in its protest of AL 747-A would result in SWG reducing its base margin for balancing account recovery dollar for dollar by the margin generated from additional year forecast customer bills and volumes. SWG submitted that ORA’s position undermines the Commission’s intent expressed in Finding of Fact No. 80, that the revenue balancing account treatment recommended by SWG and ORA protect SWG against loss of revenues.

Based on the reasons given SWG recommended that its proposals in AL 747-A should be approved effective January 1, 2006.

DISCUSSION

In D.04-03-034, the Commission adopted a modification of ORA’s attrition adjustment methodology. Neither ORA’s methodology nor the modifications adopted in D. 04-03-034 included an allowance for customer growth in calculating the attrition adjustment

ORA’s proposed attrition year methodology, referred to in D.04-03-034, included no allowance for customer growth. ORA’s proposed attrition methodology would simply have allowed 1.6 percent for increases in expenses and rate base for 2006 plus an adjustment for the pipeline replacement program. (ORA initially proposed a 1% “kicker”² for the pipeline replacement program, but then revised its proposal to allow for pipeline replacement in a different manner.)

² The kicker was an additional 1% ORA proposed to add to revenues to compensate for the costs of pipeline replacement.

By referring to the text of the decision and the evidence of A.02-02-012 we will identify just what changes D.04-03-034 intended.

In A.02-02-012, ORA clearly opposed the inclusion of customer growth in the attrition adjustment calculation. ORA's Opening Brief, p. 85, states:

"Contrary to Southwest's assertions, the attrition mechanism does not reflect changes in operating revenues caused by activity in growth, customer growth, or new mandated programs. These cost increases are specifically excluded from the attrition mechanism."

ORA's Reply Brief, p. 20 states:

"...Southwest fails to identify and remove from its attrition mechanism changes in operating expenses caused by activity in growth, customer growth, and mandated programs. These cost increases are specifically excluded from the attrition mechanism. In conclusion, if the Commission prefers Southwest's mechanism over ORA's much simpler proposal, then the above adjustments need to be made to Southwest's proposal to avoid overcompensation of the company during the attrition period."

D.04-03-034 specifically states that SWG agreed to ORA's attrition proposal subject to:

1. modifying ORA's proposed kicker increase,
2. providing an index adjustment based on constant dollar historical average of non-pipeline replacement-related capital expenditures, and
3. implementing attrition year increases plus rate relief in 2004 and 2005 in Northern California.

In its discussion of the attrition adjustment, D.04-03-034 focused on pipeline replacement and the phase-in of rate relief. No mention was made of an allowance for customer growth.

“Southwest’s changes” referred solely to those items listed above. D.04-03-034 Ordering Paragraph 11, states:

“Southwest is authorized to file advice letters and supporting workpapers requesting attrition year adjustments to rates for 2004, 2005, and 2006. The attrition year adjustments shall be calculated consistent with the Office of Ratepayer Advocates modified attrition year proposal, and may include an index adjustment based on a seven-year constant dollar historical average of non-pipeline replacement-related capital expenditures. Southwest is authorized to include revenue requirements for attrition in addition to revenue requirements that are phased-in during the four year phase-in period.”

The modification of ORA’s attrition year proposal included an index adjustment and a provision for adding the attrition year relief to other revenue requirements phased in during the following four years. Again, no mention is made of an allowance for customer growth.

We conclude that D.04-03-034 did not intend to authorize an allowance for customer growth.

SWG’s attrition adjustment methodology in its revised AL 747-A still includes an allowance for customer growth as revealed from its workpapers.

The workpapers show that in order to calculate its 2006 attrition adjustment in AL 747-A, SWG first applied current rates to 2006 estimates of gas sales to calculate what they referred to as the “2005 adjusted base margin revenues” (of \$50,173,542 for the Southern Division for example). SWG then added to that figure other attrition adjustments (net operational attrition and additional revenue related to the pipeline replacement program) to arrive at their 2006 attrition year base margin. Since the sales estimate for 2006 is higher than that for 2005, as we would expect in a growing service territory, the allowance for customer growth is a result of SWG’s application of current rates to 2006 estimates of sales.

This allowance for customer growth was explicitly included in AL 747. In that AL, SWG showed the customer allowance in its workpapers as representing the difference between the attrition year 2005 margin, and the “adjusted margin”,

again the same amount of \$50,173,542 for the Southern Division. The difference between the attrition year 2005 margin and the adjusted margin is the allowance for customer growth equal to the \$1,170,544 at issue for the Southern Division. Similar calculations were made for the \$301,628 for Northern Division. SWG thus continues to include an allowance for customer growth in AL 747-A's "2005 adjusted base margin revenues".

SWG's workpapers supporting AL 747 applied the approved attrition escalation rate, less productivity, of 1.6% to an attrition year operational amount that included customer growth. Workpapers supporting AL 747-A applied the 1.6% to an attrition year operational amount with customer growth removed. The resulting reduction is \$36,117 in the Southern Division and \$10,503 in the Northern Division. SWG believed this adjustment would address ORA's concern that no customer growth should be allowed. As noted above, however, customer growth was still included in the 2005 adjusted base margin revenues.

Effective Date

In AL 747-A, SWG requested an effective date of January 1, 2006.

SWG filed an application, dated December 29, 2005, to establish a Base Margin Shortfall Memorandum Account to record SWG's base margin shortfalls caused by a delay in the scheduled rate relief requested in Advice Letter 747-A.

SWG's authorized rate relief for the attrition adjustment will become effective on the effective date of the memo account. If no memo account is approved by the Commission, rate relief will become effective after Energy Division review.

COMMENTS

Public Utilities Code section 311(g)(1) provides that a draft resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, a draft resolution was mailed to parties for comments.

Comments were filed by SWG on March 27, 2006. DRA filed reply comments on April 3, 2006.

SWG's Comments

SWG argues that stated that D.04-03-034 did not explicitly disallow an adjustment for customer growth. SWG asserts that the record in A.02-02-012 and D.04-03-034 support SWG's attrition methodology which uses 2006 bills and volumes to calculate base margin, prior to the addition of the attrition adjustment.

SWG also propounds that the Draft Resolution effectively produces a negative operational attrition adjustment for 2006, and submits that this result could not possibly be what the Commission intended in D.04-03-034.

SWG pointed out that its rapidly growing service territory results in significant incremental operating costs that it will incur with new customers. Without the revenues from customer growth SWG would not have the revenues that would cover the additional costs of those customers. SWG said that the negative adjustment as results from the Draft provides a perverse incentive that discourages SWG from seeking additional sales over which to spread its fixed costs, a dilution generally benefiting all customers.

Finally, SWG listed the attrition escalation rates allowed by the Commission for other California utilities, and asserted that the escalation rate allowed for SWG is low compared to other utilities. SWG stated its belief that one of the primary reasons for the difference in the operational attrition escalation rates is that the methodology adopted in SWG's rate case included an annualization of base margin at currently effective rates (the basis for the customer growth estimate) a step not included in the methodology of other utilities.

SWG concluded that the Commission could not have intended for SWG to receive a negative adjustment to its operational attrition allowance, particularly when other utilities are receiving 2.5% to 3.5% of authorized base margin.

DRA's Reply Comments

First, DRA points out that a Commission decision normally includes a finding and/or ordering paragraph that affirmatively grants an authorization. In D.04-

03-034, the Commission did not authorize the inclusion of a customer growth component in the attrition methodology approved for SWG. DRA implies that SWG can't take an action that hasn't been authorized by the Commission. In any case, DRA agrees with the Draft Resolution's conclusion that the modified DRA attrition methodology, which the Commission specifically did adopt, does not include a customer growth component.

Second, ORA presented a table showing that the Draft Resolution allowed a total attrition increase of 4.56% in Southern California and an increase of 5.78% in Northern California. The Draft Resolution does not result in a negative attrition adjustment.

Third, DRA contends that the attrition adjustment resulting from the Draft Resolution actually exceeds the allowances adopted by the Commission for other utilities.

ORA's other comments repeat arguments that were made earlier.

We see nothing in SWG's comments that would cause us to alter the Draft Resolution. D.04-03-034 adopted a modified DRA attrition methodology, and this methodology did not include a customer growth component. In addition, SWG's calculation of a "negative attrition adjustment" results simply from a comparison with a 2006 base margin amount that includes a customer growth component. The inclusion of customer growth in AL 747-A does not comply with D.04-03-034.

FINDINGS

1. The Southwest Gas Corporation filed Advice Letter 747 to recover SWG's 2006 Attrition Year margin revenue pursuant to D.04-03-034 and to make other rate adjustments.
2. The Advice letter does not seek to revise margin rates for SWG's South Lake Tahoe service territory.
3. ORA protested the allowance for customer growth included in attrition adjustments for the SWG Southern and Northern California Divisions.

4. SWG submitted AL 747-A ostensibly to remove an allowance for customer growth, thereby responding to ORA's protest. SWG's workpapers, however showed that customer growth was removed only from the net operational attrition and not from the base revenue margin.
5. ORA again protested the allowance for customer growth included in 747-A.
6. SWG's allowance for customer growth in AL 747-A should be denied since D.04-03-034 did not authorize it.

THEREFORE IT IS ORDERED THAT:

1. Advice Letter 747-A is denied to the extent that customer growth is included in its 2006 attrition year adjustment methodology. Other adjustments made in AL 747-A are approved.
2. Within 30 days from the date of this resolution SWG shall submit a supplemental advice letter that omits any allowance for customer growth from its attrition year allowance. That supplemental AL will be effective either after Energy Division review, or on the effective date of a memo account approved by the Commission related to attrition rate relief.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on April 13, 2006; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director